tive, if the "purchase price" of the property is to be capitalized from the first payments made to Oesterreich, that Wilshire should be entitled to deduct as a business expense the excess payments of the appraised value of the property as rental or interest payments.

These contentions are only properly presentable in the appeal taken by the Commissioner of Internal Revenue against Wilshire. They could not properly have been presented by Wilshire in the Oesterreich case because the question of capitalization of payments made by Wilshire is a matter that applies only to Wilshire. In short, the issue of capitalization of payments is something that can be applied only to Wilshire and not to Oesterreich, since the payments were being made by Wilshire and not by Oesterreich.

It is clear that the Court in reversing the Tax Court in the Oesterreich case in effect rewrote the agreement between Oesterreich and Wilshire. An instrument which everyone concerned with for more than twenty years considered to be a lease was rewritten by the Court's decision so as to make it a contract of sale. As long as the Court was rewriting the agreement by its decision, surely it should have considered the question of capitalization of reasonable payments. To do otherwise reduces the situation to an absurdity. Stated briefly, the decision of the Court was that Wilshire shall pay as a capital investment $679,000.00 for a piece of property which was considered to be worth only $50,000.00, or at the most $75,000.00 at the time the lease was drawn in 1929.

For the foregoing reasons, the decision summarily reversing the Tax Court was reached contrary to the Court's own rules, to-wit, Rules 15 and 23.

## II.

## The Decision Is Contrary to Law.

**A. Where There Is a Lease With a Right to Purchase, the the Rental Payments Are Not Considered as Purchase Price Payments Until the Purchase Right Is Exercised or Exercisable, or Until It May Be Predicted With Certainty That the Right Will Be Exercised.**

The Court in its decision has overlooked the authorities cited by Wilshire in its brief as *amicus curiae* in the Oesterreich case, wherein the courts considered the payments to be rent in similar cases.

*Edward E. Haverstick,* 13 B. T. A. 837;

*Indian Creek Coal and Coke Company,* 23 B. T. A. 950;

*Rotorite Corporation v. Commissioner,* 117 F. 2d 245;

*Foellinger v. Smith,* 29 A. F. T. R. 1416.

In a recent case, *Breece Veneer and Panel Company v. Commissioner of Internal Revenue,* 232 F. 2d 319, decided April 26, 1956 (subsequent to the decision in the Oesterreich case), the United States Court of Appeals for the Seventh Circuit ruled that payments made under a "lease and option to purchase" agreement constituted deductible rental expense.

In the *Breece Veneer and Panel Company* case the taxpayer entered into a "lease and option to purchase" agreement with the R. F. C. in 1943 with respect to certain property. Taxpayer was to pay $100,000.00 in 60 monthly installments as "rent," after which it had the option to purchase the property for $50,000.00. The taxpayer claimed the monthly payments as deductible rental expense

under Section 23(a)(1)(A), 1939 Code, but the Tax Court disallowed the claimed deductions on the ground that the taxpayer was acquiring, through the monthly payments, an equity in the property, and the evidence indicated the R. F. C. would not have sold the property for $50,000.00, or any comparable amount. The property in question had a fair market value at the time of the agreement of $376,500.00 and was insured for $325,000.00. The evidence also showed that the R. F. C. was primarily interested in selling the property and for reasons of its own was willing to sell for a price of $150,000.00 to $185,000.00.

The Court of Appeals reversed. The taxpayer was neither bound to pay rent substantially equal to the value of the property to obtain a deed, nor was it sure to become the owner. The amount of the rent after five years lacked the substantial sum of $50,000.00 to make the taxpayer the owner. The Tax Court in applying the economic test erroneously considered the contract in retrospect. (*Benton* (C. A. 5), 197 F. 2d 745.) It was immaterial that the property proved to be a bargain to the taxpayer. The R. F. C. probably would not have sold the property for $50,000.00 in 1943 but a large decline in the value reasonably could be expected by 1948. The plant was not modern and the equipment was old. However, the *Benton* case held that the economic test in itself is only one of the factors to be considered to determine the intention of the parties. The evidence relating to 1943 negates the intention of building up an equity. The taxpayer rented the whole of the premises, instead of 30% as it formerly did for $700.00 per month. There was evidence that the fair gross rental value of

the entire premises was $45,000.00 per year. Taxpayer was threatened by a possible lease of the entire property to another tenant, and it could reasonably anticipate a considerable reduction of its rent by a sublease of part of the premises to the other tenant.

The taxpayer in a 1941 letter to the R. F. C. had offered to buy its portion of the premises on a contract for deed for $100,000.00 with a down payment of $6,000.00 and later suggested a lease with the rent to apply on the purchase price. The intention of the parties cannot be determined unilaterally. The R. F. C. evidently did not agree with the taxpayer as to the terms of the contract and consummated the transaction in the form of a lease drawn by the R. F. C. with a sublease to the other tenant. The R. F. C. was attempting to protect itself in the transaction by a lease. In case of default in rent it would be easier to regain possession from a tenant than to foreclose or forfeit a contract to purchase and dispossess the purchaser. The taxpayer could exercise the option or not, but in the meantime the payments were neither to be applied on the purchase price, nor were the monthly payments to be made by the taxpayer more than the reasonable rental value.

**B. A Review Is Limited to Questions of Law.**

The Court in its decision in the Oesterreich case overlooked the principle of law that an Appellate Court will not weigh testimony, and as long as there is ample evidence in the record to sustain the findings of the lower court it will not reverse those findings of fact.

The Tax Court found that Exhibit 1 was a lease, on the basis of the evidence, both written and oral. Since

there is a reasonable basis for the Tax Court's decision, the Appellate Court should uphold the decision of the trier of fact.

*Corn Products v. Commissioner of Internal Revenue*, 76 S. Ct. Rep. 20.

Tax Court's findings of fact is not to be set aside by court, even if upon examination of evidence court might draw a different inference.

*Jurs v. C. I. R.* (C. C. A. 9, 1945), 147 F. 2d 805.

The skilled judgment of the Tax Court, which is the basic fact-finding and inference-making body, should be given wide range in tax proceedings involving factual disputes.

*C. I. R. v. Scottish American Inv. Co.* (1944), 65 S. Ct. 169.

It is province of Tax Court to determine facts.

*Rider v. C. I. R.* (C. A. 8, 1952), 200 F. 2d 524.

Inferences of fact made by Tax Court in tax case will not be disturbed on appeal by Court of Appeals unless clearly erroneous.

*Benton v. C. I. R.* (C. A. Tex., 1952), 197 F. 2d 745.

Strict findings of fact by the Tax Court are beyond controversy on petition to review the Tax Court's decision in the Court of Appeals.

*Three States Lumber Co. v. C. I. R.* (C. C. A. 7, 1946), 158 F. 2d 61.

Determination of a question of fact by Tax Court, supported by competent evidence, is not open for determination in Court of Appeals.

*Welsbach Engineering & Management Corporation v. C. I. R.* (C. C. A. 3, 1944), 140 F. 2d 584, cert. den. 64 S. Ct. 1261.

Other cases to the same effect are:

*Aviation Club of Utah v. Commissioner*, 162 F. 2d 984;

*Richards v. Commissioner*, 84 F. 2d 369;

*American Pacific Whaling Co. v. Commissioner*, 100 F. 2d 46;

*Woodall v. Commissioner*, 105 F. 2d 474;

*Blair v. Curran*, 24 F. 2d 390.

## III.

## The Decision Is Contrary to the Evidence.

### A. The Real Intent of the Parties Was to Effect a Lease Rather Than a Sale.

In reversing the decision of the Tax Court in the Oesterreich case the reviewing Court disregarded the *real* intent of the parties and jumped to an erroneous conclusion that the intent of the parties was to transfer title. The evidence was clear that the parties intended a lease, not because they called it a lease but because all of the indicia of a lease were present:

1. During all of the years from 1929 on Wilshire entered all amounts paid to Oesterreich as rental expense and reported it as such. [Stip. par. 8, p. 35, and pp. 68-69.]

2. Oesterreich entered all amounts received from Wilshire from the year 1929 on as rental income upon her books and reported said amounts as rental income on her income tax returns. [Stip. par. 9, p. 35; pp. 68, 126-127.]

3. Never did it occur to Oesterreich that the instrument was not a lease until a revenue agent so advised her. [p. 139.] The agent's findings were included in a report dated December 14, 1948. [Pp. 16-20.] The revenue agent was reversed by the office of the Internal Revenue Agent in Charge, and Oesterreich was so advised on July 26, 1949. [Pp. 21-24.]

4. In January of 1929 the late A. H. Chotiner and his son Albert Jack Chotiner, officers of the corporate predecessor of Wilshire, informed W. Frank Moulton that they proposed to construct a theatre, and sought a long term ground lease. [Dep. pp. 6, 11.]

5. Oesterreich owned three lots on Wilshire Boulevard at Hamilton in Beverly Hills and informed Moulton she was willing to enter into a long term lease, but did not want to sell the land. [Dep. pp. 11, 33.] The Chotiners informed Oesterreich they wished to lease her land. Oesterreich said she was willing to enter into a long term ground lease if suitable terms could be arranged. [Pp. 145, 148.]

6. Negotiations extended over a period of approximately nine months and culminated in the making of a lease dated September 11, 1929. [Stip. par. 3, p. 33; Dep. pp. 41, 61, 83.]

7. During the negotiations Oesterreich stated on several occasions she did not expect to be alive at the end of the term of the lease and was indifferent to the disposi-

tion of the fee at that time, but was interested in securing a substantial rental during her lifetime. [P. 154; Dep. pp. 24, 27, 50, 64.]

8. No offer to buy the land was ever made during the course of negotiations. [Pp. 134, 160, 165; Dep. pp. 23, 31.]

9. Although it was alleged that an option was requested to purchase the land, Oesterreich refused to grant or allow an option to purchase. [Pp. 137-138; Dep. p. 36.]

10. At no time during the course of negotiations did either of the parties discuss the sale of the land, and Oesterreich did not offer to sell the land. [P. 146; Dep. pp. 22, 24-25.]

11. The parties did not discuss the value of the land at any time during the negotiations. [Pp. 165-166; Dep. pp. 26-27.]

12. The execution of the lease was not preceded by an oral agreement to purchase. [Dep. p. 31.]

13. The tax consequences of the lease were not considered by any of the parties. [P. 140.]

14. At the time the lease was negotiated the land had a value of not less than $50,000.00 and not more than $75,000.00. [P. 74; Dep. pp. 18, 46.]

15. Moulton, the real estate agent, was paid a commission by Oesterreich for finding a tenant. [Dep. pp. 19-22, 56, 63.]

16. There is a difference between a sales commission and a rental commission. [Dep. p. 21.] The commission for a sale was a straight 5%. [Dep. p. 57.] Rental Commission is based on the Realty Board Book. [Dep. p.

58.] The Realty Board Book provides for 3% of the rentals for the first five years of the lease and 1½% on the rentals for the balance of the term.

17. The agreement of the parties was recorded in the office of the County Recorder as a lease. [Stip. par. 3, p. 33.]

18. The lease was executed by the parties after consultation and advice of their legal counsel. [Pp. 110-111.]

19. In financing the construction of the building a deed of trust was given as security. The deed of trust was prepared by the outstanding law firm of O'Melveny, Tuller and Myers, attorneys for the trustee Security-First National Bank of Los Angeles. The deed of trust referred to the provisions of the "Oesterreich lease," and recited that Oesterreich was the owner of the real property and that a leasehold interest was created by the lease. [Ex. 7; pp. 114-115, 155.]

20. The deed of trust was executed by Oesterreich after consultation and advice of her legal counsel. [Pp. 114-115.]

21. In 1940 Oesterreich and Wilshire entered into an agreement which provided that Oesterreich was the owner and Wilshire the present lessee. The agreement provided that in consideration of Oesterreich's joining in the execution of a note secured by a deed of trust on the said real property that the lessor (Oesterreich) was to receive $7,500.00. [Ex. 8; pp. 121-122, 156-157.]

22. In 1944 Wilshire paid Oesterreich an additional $2,500.00 to secure her signature as owner of the land to refinancing papers in connection with a new loan. [P. 158.]

23. Rental payments made pursuant to the lease were paid to a bank in Los Angeles in accordance with the assignment of rents executed by Oesterreich. [Ex. 14; pp. 169-170.]

24. On several occasions Oesterreich and Wilshire executed notices of non-responsibility which recited that Oesterreich was the owner and Wilshire the lessee. [Ex. 11; pp. 160-161.]

25. The rental payments from the 68-year term of the lease will aggregate almost $700,000.00, approximately 10 to 14 times the value of the property. [Pp. 74, 166; Dep. pp. 18, 46; Ex. p. 1.]

The Court in holding that the transaction was a sale instead of a lease is rewriting an agreement entered into between parties who were represented by counsel.

The result of the Court's decision is highly artificial, because it is obvious that even if there really was "a sale" that a substantial part of each annual payment is attributable as interest. The denial of any deduction to the lessee-"purchaser" for these payments is grossly unfair. It should be noted in this connection that it now seems to be administrative policy in lease-purchase cases to recognize an interest deduction to the lessee-purchaser.

It is obvious that the rent being paid by Wilshire greatly exceeded the value of the remainder interest. The decision would be less unrealistic if it recognized that the "selling price" was only the reasonable value of the property so that the interest factor or the difference in the rents would be taxable to the lessor and deductible by the lessee.

**B. There Was a Valuable Consideration for the Future Transfer of Title Other Than the Monthly Payments.**

The Court in its decision overlooked the consideration which passed from the predecessor in interest of Wilshire to Oesterreich wherein Oesterreich had the use and advantage of Lot 555 and the northerly 40 feet of Lot 556, which the predecessor in interest of Wilshire purchased and conveyed to Oesterreich so the additional land could be used for the construction of the theatre building.

The two lots which were purchased by Wilshire's predecessor were required and necessary to build a building large enough to accommodate a motion picture theatre of the size which was constructed. By so doing, additional rental for the theatre was obtained, which enabled the lessee of the Oesterreich property to pay a larger ground rental to Oesterreich. Accordingly, Oesterreich received a substantial benefit in return for which she was deeding the property at the end of 68 years.

The two lots purchased and conveyed to Oesterreich in 1929 cost the predecessor in interest of Wilshire $19,650.00. [Stip. par. 4, p. 34.]

The three lots owned by Oesterreich cost her $24,235.05. [Pp. 32-33.]

The Court in its decision also overlooked the consideration which passed from the predecessor in interest of Wilshire to Oesterreich wherein the payments originally contemplated to increase from $7,500.00 a year to $12,000.00 a year progressively, and then to remain at $12,000.00 a year at the end of fifty years until the termination of the lease 18 years thereafter, were changed so that Oesterreich received $12,000.00 a year for the 11th to 28th years, and the payments diminished pro-

gressively from $12,000.00 a year to $7,500.00 a year from the 29th to the 68th year. This gave Oesterreich the advantage of additional funds during an earlier period of the lease.

The Court in its decision assumes that the transaction between Wilshire and Oesterreich was a sale simply because Wilshire acquires title on the payment of $10.00 at the end of 68 years. The real consideration, however, is not $10.00, but the use of the two lots which Oesterreich received as well as the use of larger early payments which were to be made at an earlier period during the lease, as set forth hereinabove.

It should be kept in mind that this is a single purpose building with the main tenant a motion picture exhibitor. What the future holds for the motion picture exhibiting business in 1997 is open to conjecture.

Whether the building in 1997 would be razed because of its unsuitability at that time is something that cannot be determined now except to say that motion picture theatre buildings ordinarily are not expected to be of value 68 years after their construction.

The Court in its decision has assumed that the land will become more valuable, but there was no evidence to show that the land would be more valuable in 1997 than at present. With the changing trends of migrations of peoples, businesses and industry, one cannot predict whether the land in question will be more valuable in 1997 than it is at present. Many areas in and around Los Angeles were thought to be on the upward trend in value, but subsequent events proved that they retrogressed instead.

The Court in its decision erred when it stated that the agreement provided for a tapering off of rental payments in later years because that was what the lessees could afford to pay. The record is silent as to what the lessees could afford to pay at the end of 28 years. The payments were reversed simply because Oesterreich wanted to get the bulk of the income as early as possible. [P. 154; Dep. pp. 24, 27, 50, 64.]

When the Court stated that the property will be worth perhaps ten times as much in 1997 as it was in 1946; it has endeavored to look into the future and foretell an event for which no evidence was submitted as to what the property would be worth in 1997.

Here again it should be kept in mind that this is a single purpose building.

According to Table 4, page 1089, Handbook of Financial Mathematics by Justice H. Moore of the Irving Trust Company published in 1944 by Prentice-Hall, Inc. (third printing), the following table sets forth the value of the reversions in 1929, assuming various fair market values of the three lots in 1929:

| Value of Land in 1929 | Value of Reversion in 1929 |
|---|---|
| $24,235.05 | $129.31 |
| 50,000.00 | 266.78 |
| 75,000.00 | 400.17 |

It will be seen that Oesterreich gave up very little when she agreed to sell her reversionary interest presumably for $10.00. On the other hand, what she received was very substantial; she received the benefit of two lots which cost $19,650.00; she received the benefit of $12,000.00 a year rent after the first ten years, instead of having to wait 40 years for the rent to reach that figure.

In the event Wilshire defaults in any of the monthly payments to Oesterreich it not only could be dispossessed of the property, but Oesterreich would be entitled to keep title to the two lots which had been conveyed to Oesterreich by Wilshire's predecessor in interest.

It is far more realistic to say that the consideration for the transfer of title to the property at the end of 68 years was the use by Oesterreich of the two lots, with the possibility that she would be entitled to retain title thereto, and the shifting of rental payments during the course of the lease hereinabove mentioned, than it is to say that Wilshire was paying almost $700,000.00 for a piece of property which was never considered to be worth more than $75,000.00 at the time the agreement was signed.

**C. Wilshire Holding Corporation Has Not Acquired an Equity in the Property.**

The Court in its decision ignores the fact that Wilshire to this date has not acquired an equity in the property, as the amount still owing under the contract is far in excess of the appraised value of the land. The land at the time of the hearing only had a value of $100,000.00. [P., 74.] Therefore, no equity has been acquired.

When the unpaid balance under the contract has diminished to a point where it no longer exceeds the appraised value of the land, then that will be ample time to determine the question of whether Wilshire is acquiring an equity in the property. Until that point is reached, it is purely a payment of rent.

While it is true that the price of a piece of property on a deferred payment plan may be greater than a cash

sale price, nevertheless the difference between the amount agreed to be paid under the contract and the appraised value of the land must not be so great and so disproportionate as in the present case.

The findings of the Tax Court are that the three lots were worth not more than $50,000.00 in 1929 and not more than $100,000.00 in 1946. [P. 178.] These findings are supported by the testimony of W. Frank Moulton, the real estate agent, that the property was worth $50,000.00 [Dep. pp. 18, 46], and by the testimony of Albert Jack Chotiner that it was worth between $50,000.00 and $75,000.00. [P. 166.]

It is beyond reasonable comprehension that $679,000.00 would be paid for a piece of property that was appraised at only $50,000.00.

**D. The Payments by Wilshire Holding Corporation Are Commensurate With the Benefits Derived by It.**

The Court in its decision erred when it stated that the schedule of payments was not commensurate to the benefit derived by Wilshire from the occupancy and use of the land. The Court overlooked the fact that at an appraised value of $50,000.00 as shown by the testimony, the yield for the first 10 years was 15% per annum; the yield for the next 18 years was 24% per annum; and the yield thereafter decreased from 24% to 15% per annum.

Surely that was a fair return to the lessor, and an expense commensurate with the benefit derived by Wilshire.

## Conclusion.

For the reasons set forth above, and because of the conflict in the decisions of various Circuits of the United States Court of Appeals, and the far-reaching consequences of the decision of the United States Court of Appeals for the Ninth Circuit, it is respectfully submitted that this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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## APPENDIX "A."

### In the United States Tax Court.

Walburga Oesterreich, vs. Commissioner of Internal Revenue; and Wilshire Holding Corporation vs. Commissioner of Internal Revenue.

Docket Nos. 32946 and 32954, Filed March 9, 1953.

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MEMORANDUM FINDINGS OF FACT AND OPINION.

The Commissioner determined a deficiency in income tax of $141.16 for 1946 against Walburga Oesterreich and deficiencies against Wilshire Holding Corporation of $1,584 in declared value excess profits tax, $3,097.83 in excess profits tax and $1,834.06 in income tax, for 1945, and $2,798.20 in income tax for 1946. The only issue for decision is whether payments made by Wilshire Holding Corporation to Walburga Oesterreich for the taxable years were deductible by the corporation as expenses for rent under section 23(a)(1)(A) and returnable by Walburga as ordinary income or whether they were in whole or in part payments of purchase price of land.

FINDINGS OF FACT.

Walburga Oesterreich, a widow, filed her individual income tax return for 1946 with the collector of internal revenue for the Sixth District of California. Wilshire Holding Corporation filed its returns for the taxable years with the collector of internal revenue for the Sixth District of California.

Walburga Oesterreich acquired three adjoining lots, 552, 553 and 554, in January, 1926. One of the lots was on the corner of Wilshire Boulevard and Hamilton Drive in

Beverly Hills, California. She paid $20,000 for three lots and thereafter spent $4,235.05 for paving and lighting assessments properly chargeable to capital account in respect of the lots, so that her adjusted basis for the lots on September 11, 1929, was $24,235.05.

Wilshire Amusement Corporation was incorporated in 1929 by Albert H. and Albert J. Chotiner, father and son, for the purpose of building a motion picture theatre. They directed a real estate broker, operating in Beverly Hills, to find a suitable location which they could lease and on which they could construct a theatre. The broker learned from Walburga that she would be willing to enter into a lease for the three vacant lots which she owned, he arranged a meeting between the Chotiners and Walburga and, and after negotiations, Walburga and Wilshire Amusement Corporation entered into an agreement entitled "lease" dated September 11, 1929. The Chotiners decided, in the course of the negotiations, that additional land would be needed for the theatre which they desired to build and for that reason Wilshire Amusement Corporation purchased lot 555 and the northerly 40 feet of lot 556 at a total cost to it of $19,650. Wilshire conveyed that land to Walburga in the fall of 1929.

Walburga is referred to as lessor and Wilshire Amusement Corporation is referred to as lessee throughout the agreement of September 11, 1929. It provides for payments called "rent" to be paid by the lessee to the lessor. It covers lots 552, 553, 554, 555 and the north 40 feet of lot 556 and provides that the lessor lets those properties to the lessee for a term of 67 years and eight months beginning September 1, 1929, and ending on the last day of April, 1997. The lessee agreed to pay the lessor total rent of $679,380 payable in monthly installments in ac-

cordance with a rental schedule. The rental schedule provided for an annual rental of $7,500 for the first 10 years, $12,000 for the succeeding 18 years and amounts becoming progressively smaller at the rate of $113.40 each year so that the rental for the 68th year was $7,500. The lessee agreed to pay all taxes and similar charges on the property. The lessee agreed to erect a new building on the premises to cost not less than $300,000 and to be completed not later than July 1, 1930. The lessor agreed to join in the execution of notes or debentures and in a deed of trust or mortgage covering the leased premises to secure a loan not to exceed $225,000 to be used in constructing the building. The lessee agreed to take out adequate fire insurance on the building and insurance to protect the lessor from claims arising out of the use of the premises. The agreement states that the lessee proposes to sublease a portion of the building for theatre purposes. The lease could be assigned by the lessee upon the terms stated therein and such an assignment would release the lessee of further obligations under the lease. The lessor could declare the lease terminated in case of a default continuing longer than a period stated in the lease. The lessee had the right, but was not bound, to tear down any building which might be built on the premises for the purpose of reconstruction in accordance with the terms of the lease should the original building become obsolete or not suited to the purposes of the lessee. Any such replacement building was to cost not less than $325,000. One paragraph of the agreement was as follows:

> The Lessor hereby promises and agrees that, upon the expiration of the term of this lease by lapse of time, and when all of the terms and conditions of

this lease have been met and all of the rentals and other payments provided to be paid shall have been paid at the times and in the manner provided, the Lessor promises and agrees that she will then, upon the payment to her of the further sum of ten dollars ($10.00) in hand, convey or cause to be conveyed by grant deed to the Lessee free and clear of all encumbrance, all of the real property herein leased, without further or other consideration.

The agreement was recorded in the Official Records of Los Angeles County.

Walburga Oesterreich; in entering into the agreement, was interested in receiving as much income from lots 552, 553 and 554 as was possible; she had no relatives or heirs in whom she was interested; and she expected to die long before 1997; and she did not care what became of the title to the property after the term of the agreement. She did not want to sell the lots. She did not execute any deed for the property to be used in transferring title at the end of the period of the lease after April 30, 1997. The Chotiners, in having Wilshire Amusement Corporation enter into the agreement of September 11, 1929, were not interested in buying lots 552, 553 and 554, but desired a long term lease of these lots.

Wilshire Amusement Corporation changed its name to Wilshire-Hamilton Properties, Inc., shortly after September 11, 1929, and is hereafter referred to as Hamilton. Wilshire Holding Corporation, the petitioner, succeeded to the interest of Hamilton under the agreement of September 11, 1929, in August, 1935.

The agreement of September 11, 1929, has been carried out in accordance with its provisions. Hamilton and Wilshire Holding Corporation entered upon their books of account all amounts paid or payable on account of their obligations under that agreement as rental expense and Walburga entered upon her books of account all amounts paid or payable on account of those obligations as rental income. The payers claimed deductions on their Federal tax returns for the amounts paid as rent and Walburga reported the amounts received as rent.

Wilshire Holding Corporation paid Walburga $12,000 in each of the years 1945 and 1946 in accordance with the provisions of the agreement of September 11, 1929.

Walburga, on her returns for 1945 and 1946, reported the $12,000 as income from rents. The Commissioner, in the notice of deficiency dated December 12, 1950, made no change in that item. Walburga received a letter from an Internal Revenue Agent in Charge indicating over-assessments in her income tax for 1945 and 1946 and enclosing a report in which it was stated that she had reported rental income of $12,000 for the years 1945 and 1946 but investigation showed that the agreement under which those payments were made was "not a lease, but in effect an installment sale of the realty under Section 44(b) of the Internal Revenue Code," and she overstated her income for each year by $6,206.91 in that connection. She received another letter from the same source dated July 26, 1949, stating that the conclusion had been reached that the rents were correctly reported on her income tax returns.

The Commissioner, in the notice of deficiencies to Wilshire Holding Corporation, dated December 12, 1950, held:

> On each of your returns for the years 1945 and 1946 you deducted $12,000.00 as rent paid. Inasmuch as the so-called "lease" under which these amounts were paid provides that the demised property shall be deeded to you for a nominal consideration upon the payment of a certain specified sum in monthly installments, including the above amounts, it is held that the monthly payments constitute capital expenditures and the claimed deductions are therefore disallowed.

Lots 552, 553 and 554 were worth not more than $50,000 in 1929 and were worth not more than $100,000 in 1946. Wilshire Holding Corporation had not taken title to, was not taking title to, and had no equity in those lots at the end of 1946. The $12,000 payments made by Wilshire Holding Corporation to Walburga Oesterreich in 1945 and 1946 were ordinary and necessary expenses of Wilshire Holding Corporation paid or incurred during the taxable years in carrying on its business and were rentals or other payments required to be made as a condition to the continued use or possession for the purpose of its business of lots 552, 553 and 554. Those payments were ordinary income of Walburga Oesterreich.

All facts stipulated by the parties are incorporated herein by this reference.

OPINION.

MURDOCK, *Judge:*

Walburga and the predecessor of the corporate petitioner entered into the agreement in 1929 which was called a lease and which provided for payments called rent to be paid by the lessor to the lessee. The words they used are not controlling but are not without significance. Both parties have indicated consistently by their many actions for approximately 20 years that they originally intended it to be and always regarded it as a lease under which the payments were rentals. Walburga recorded and reported the payments annually as rents. The corporate petitioner and its predecessor recorded and deducted those payments as rents. The Commissioner raised no objection to those actions of the parties during all of that period and apparently it was not until December 14, 1948, that a Revenue Agent first made the suggestion, later withdrawn, that the payments were not rentals but purchase price. A remainder interest after a 68-year lease in vacant lots such as these, which had a value in 1929 of not more than $50,000 at the most, was trivial in comparison to the annual rentals and would probably not equal half of the rent for the first month. The agreement is like a lease in that it requires payments for the use of the property over a long period of time. If the annual payments were to be regarded as purchase price, they would be out of proportion to the value of the lots. Walburga owned only vacant land in 1929 and the payments made prior to the beginning of 1947 created no equity in Wilshire Holding Corporation in lots 552, 553 and 554 since the then present value of the future payments to be made under the agreement far

exceeded the value of those lots. It seems unrealistic, under all of the facts in this case, to hold that the payments during 1945 and 1946 were not rental payments, deductible by the payer and returnable as income by the payee. The Court concludes that the Commissioner erred in the case of Wilshire Holding Corporation in denying the deductions of $12,000 claimed on its returns. He did not err in determining the deficiency against Walburga Oesterreich.

Decision will be entered for the respondent in Docket No. 32946 and under Rule 50 in Docket No. 32954.

## APPENDIX "B."

In the United States Court of Appeals for the Ninth Circuit.

Walburga Oesterreich, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 13924.

Filed October 29, 1955.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

Before: Fee and Chambers, Circuit Judges, and Ling, District Judge.

LING, *District Judge:*

This case is here on petition to review a decision of the Tax Court relating to a deficiency assessment. The following facts are not in dispute:

Petitioner, Walburga Oesterreich, acquired three adjoining lots, 552, 553 and 554, in January, 1926. One of the lots was on the corner of Wilshire Boulevard and Hamilton Drive in Beverly Hills, California.

Wilshire Amusement Corporation was incorporated in 1929 by Albert H. and Albert J. Chotiner, father and son, for the purpose of building a motion picture theatre. They directed a real estate broker, operating in Beverly Hills, to find a suitable location which they could lease and on which they could construct a theatre. The broker learned from Walburga that she would be willing to enter into a lease for the three vacant lots which she owned and he arranged a meeting between the Chotiners and Walburga. After negotiations, Walburga and Wilshire Amusement Corporation entered into an agreement entitled "lease" dated September 11, 1929. The Chotiners

decided, in the course of the negotiations, that additional land would be needed for the theatre which they desired to build and for that reason Wilshire Amusement Corporation purchased lot 555 and the northerly 40 feet of lot 556 at a total cost to it of $19,650. Wilshire conveyed that land to Walburga in the fall of 1929.

Walburga is referred to as lessor and Wilshire Amusement Corporation is referred to as lessee throughout the agreement of September 11, 1929. The "lease" agreement provides for payments called rent to be paid by lessee, Wilshire Amusement Corporation to lessor, the taxpayer. The lessee agreed to pay the lessor total rent of 679,380 payable in monthly installments for a period of 67 years and eight months beginning September 1, 1929 and ending the last day of April, 1997. The rental schedule provided for an annual rental of $7,500 for the first 10 years, $12,000 for the succeeding 18 years and amounts becoming progressively smaller so that the rental for the 68th year was $7,500. The lessee agreed to pay all taxes and similar charges on the property. The lessee agreed to erect a new building on the premises to cost not less than $300,000 and to be completed not later than July 1, 1930. The lessor agreed to join in the execution of notes or debentures and in a deed of trust or mortgage covering the leased premises to secure a loan not to exceed $225,000 to be used in constructing the building. The lessee agreed to take out adequate fire insurance on the building and insurance to protect lessor from claims arising out of the use of the premises. The agreement states that the lessee proposes to sublease a portion of the building for theatre purposes. The lease could be assigned by the lessee upon the terms stated therein and such an assignment would release the lessee

of further obligations under the lease. The lessor could declare the lease terminated in case of default continuing longer than a period stated in the lease. The lessee had the right, but was not bound, to tear down any building which might be built on the premises for the purpose of reconstruction in accordance with the terms of the lease should the original building become obsolete or not suited to the purpose of the lessee. Any such replacement was to cost not less than $325,000.

One paragraph of the lease provided that when the lease expired and all conditions met, the

> "lessor promises and agrees that she will then, upon the payment to her of the further sum of ten dollars ($10.00) in hand, convey or cause to be conveyed by grant deed to the Lessee free and clear of all encumbrance, all of the real property herein leased, without further or other consideration."

The agreement was recorded in the Official Records of Los Angeles County.

Wilshire Amusement Corporation changed its name to Wilshire-Hamilton Properties, Inc., shortly after September 11, 1929. Wilshire Holding Corporation succeeded to the interest of Hamilton under the agreement of September 11, 1929, in August, 1935.

Wilshire Holding Corporation paid the taxpayer $12,000 in each of the years 1945 and 1946 in accordance with the agreement and entered the amounts so received as rental expense. The taxpayer, on her returns for 1945 and 1946, reported the $12,000 as income from rents. She received a letter from an Internal Revenue Agent in Charge indicating over assessments in her income tax

for 1945 and 1946, and enclosing a report in which it was stated that she had reported rental income of $12,000 for the year 1945 and 1946, but investigation showed that the agreement under which these payments were made was "not a lease, but in effect an installment sale of realty under Section 44(b) of the Internal Revenue Code," and she overstated her income for each year by $6,206.91 in that connection. She received another letter from the same source dated July 26, 1949, reversing the previous conclusion and stating that the rents were correctly reported as income on her previous tax returns.

The Commissioner determined a deficiency in income tax of $141.16 for 1946 against Walburga Oesterreich and deficiencies against Wilshire Holding Corporation of $1,584 in declared value excess profits tax, $3,097.83 in excess profits tax, for 1945, and $2,798.20 in income tax for 1946.

The Tax Court entered its decision sustaining the Commissioner's determination of deficiency in the taxpayer's income tax for the year 1946.

There is only one issue presented ~~by this case. Is~~ petitioner entitled to treat "rental" payments made by "lessee" as long term capital gains or must she treat them as ordinary income? Conversely, is lessee, the Wilshire Holding Corp., entitled to treat these payments as a deductible business expense as defined by Int. Rev. Code Sec. 23(a)(1)(A), or merely as non-deductible capital expenditures? The sole issue, therefore, is whether the agreement is a lease or a contract for the sale of land. The courts, in making determinations of this sort, commonly consider the intent of the parties and the legal effect of the instrument as written.

It seems well settled that calling such a transaction a "lease" does not make it such, if in fact it is something else. Judson Mills, 11 T. C. 25 (1948); Robert A. Taft, 27 B. T. A. 808 (1938). To determine just what it is the courts will look to see what the parties intended it to be. Benton v. Commissioner, 197 F. 2d 745 (5th Cir. 1952). Both petitioner and Wilshire Holding Corp. have at all times referred to the agreement as a lease and they have treated the payments as rental income and rental expense respectively. For this reason, perhaps, the Tax Court assumed that the parties intended a lease. However, the test should not be what the parties call the transaction nor even what they may mistakenly believe to be the name of such transaction. What the parties believe the legal effect of such a transaction to be should be the criterion. If the parties enter into a transaction which they honestly believe to be a lease but which in actuality has all the elements of a contract of sale, it is a contract of sale and not a lease no matter what they call it nor how they treat it on their books. We must look, therefore, to the intent of the parties in terms of what they intended to happen.

It is clear that it was intended that title to the premises was to pass to lessee at the end of the 68 year term. The testimony of the parties makes this explicit. Therefore, if the only test in determining whether it was a sale or lease was the passing of title, the parties intended a sale and not lease.

Testimony was offered to the effect that petitioner wanted the bulk of the consideration for the "lease" as soon as possible so that she could enjoy the money during her lifetime. Consequently, the agreement which pro-

vided for a tapering off of the rental payments in the later years was tailored to suit her needs and to what the lessees could afford to pay. This was the intent of the parties and this is what went into the agreement. Here we see that what the parties intended and the legal effect of the transaction were one and the same, so we should not consider the intent of the patries apart from the legal effect of the agreement.

The question before us remains whether petitioner is entitled to treat her rental payments as long term capital gains rather than rental income and conversely whether Wilshire Holding Corporation is entitled to deduct the payment as rental expense as defined by Sec. 23(a)(1)(A) which provides as follows:

> "In computing net income there shall be allowed as deductions:
>
> (a) Expenses.—
>
> (1) Trade or Business Expenses.—
>
> (A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken *or is not taking title or in which he has no equity.*" (emphasis supplied)

If Wilshire Holding Corporation is either taking title to the property or has acquired an equity, it cannot treat the payments from Wilshire as rental income. It is important to note that these two provisions of Sec. 23(a)

(1)(A) are stated in the alternative and the deduction cannot be availed of if Wilshire Holding Corporation has brought itself into either category prohibited by statute. Dupont v. Deputy, 22 F. Supp. 589, 599 (D. C. Dela. 1938), *modified on other grounds*, 103 F. 2d 257 (3rd Cir. 1939), *cert. granted*, 308 U. S. 533 (1939), rev'd on other grounds, 308 U. S. 488 (1940). In Helser Machine & Marine Works, 39 B. T. A. 644, 645, 646 (1939) the court stated,

> It is not necessary to hold that by payment of the rental petitioner acquires an "equity," for that word is not easy to define; it is enough that the lease provides a right in the petitioners to take title to the premises for which the rental was paid.

This language was cited with approval in Judson Mills, 11 T. C. 25 at 33 (1948). See also *In re* Rainey, 31 F. 2d 197 (D. C. Mary. 1927) (non-tax). We find, therefore, that the Tax Court was in error for it ignored this alternative ground of taking title and based its decision on the ground that it believed Wilshire Holding Corporation had not yet acquired an equity in the premises.

There can be no doubt that Wilshire Holding Corporation is acquiring title to the premises. At the expiration of the lease it can acquire premises now worth $100,000 for the token consideration of $10. Although there have been cases holding that a mere option to buy at the expiration of the time period does not turn a lease into a contract of sale, Benton v. Commissioner, *supra*, 197 F. 2d 745; Indian Creek Coal & Coke Co., 23 B. T. A. 950 (1931); Haverstock, 13 B. T. A. 837 (1928), it should be noted that in all of these cases, the option price constituted full consideration for the premises or goods ac-

quired. In each of these cases it was always questionable whether or not the options would be exercised. Here there is virtually no question of this, for not only will Wilshire Holding Corporation acquire valuable land for a mere $10 but it will forfeit a $350,000 building now on the premises to the lessor if it does not decide to pay the $10 and take title. The testimony clearly shows that the Wilshire Holding Corporation during all of the original negotiations was very much concerned with what would happen to its building and the land after the lease expired and would not have agreed to the "lease" unless it provided that title would vest in Wilshire.

Another factor leading to the conclusion that the parties at the time of the transaction intended a sale is that the schedule of payments under the so-called lease was not commensurate to the benefit derived by Wilshire from the occupancy and use of the land, for instead of rising toward the end of the lease as the land on Wilshire Boulevard became more valuable the payments decreased.

The alternative criterion under Sec. 23(a)(1)(A) which would prevent Wilshire Holding Corporation from treating the payments as a business expense is whether an equity in the property was acquired. The Tax Court in applying this test held that since the amount due on the remaining portion of the lease greatly exceeded the appraisal value of the property, Wilshire Holding Corporation had not yet acquired an equity. We, however, do not believe that this method of determining whether an equity has been acquired is correct. From 1929 to 1946 Wilshire Holding Corporation paid approximately $100,000 to the lessor. In 1997 it will acquire property appraised at $100,000 in 1946 and worth perhaps ten

times as much by 1997. Certainly a part of each payment is going toward the acquisition of this land and to this extent Wilshire Corporation does have an equity. In Chicago Stoker Corp., 14 T. C. 44 (1950), the court said that if the payments made under the "lease" are large enough to exceed the value of the property less depreciation, the lessee is receiving an equity in the property. Although the Stoker case is distinguishable on its facts, the same principle should apply here.

However, even if the Tax Court was correct in holding that Wilshire has not acquired an equity, the alternative ground that they are taking title to the property is sufficient to disqualify the "rental" payments from being treated as a business expense.

Looking at this transaction from a long range view we find that if the opinion of the Tax Court is affirmed, Wilshire Holding Corporation, at the expiration of the "lease," will have acquired a very valuable piece of property for payments written off entirely as business expense while petitioner will have, in effect, sold a valuable piece of property without having been able to treat the proceeds as a long term capital gain.

We are of opinion that the Tax Court erred in treating the question of intention of the parties as one of fact collateral to the written instrument. The document was not ambiguous, and evidence as to surrounding circumstances was not required to explain it. The intention of the parties, as expressed in the instrument, was cardinal, as has been said above. The document has here been construed in the light of the applicable statute. No question of fact was involved. One who contracts to purchase real property acquires an equity therein immediately on

signing of the contract to purchase and taking possession. This equity increases with every payment. No comparison of the value of the realty and the amount of rental paid at any given time has any validity.

The decision of the Tax Court is reversed.

(Endorsed): Opinion. Filed Oct. 29, 1955.

Paul P. O'Brien, Clerk.

## APPENDIX "C."

In the United States Court of Appeals for the Ninth Circuit.

Commissioner of Internal Revnue, Petitioner, vs. Wilshire Holding Corporation, Respondent. No. 14100—Memorandum.

Filed Dec. 6, 1956.

A motion has been filed by the Commissioner of Internal Revenue in the above entitled cause, that the decision of the Tax Court therein be summarily reversed.

The above entitled case was consolidated in the Tax Court with the case of Walburga Oesterreich v. Commissioner of Internal Revenue No. 13,924. Pursuant to a stipulation of the parties proceedings on appeal in the above entitled case No. 14,100 have been held in abeyance pending the decision of the court in the Oesterreich case No. 13,924. The Wilshire Holding Company had its day in court since it was permitted to file a brief *amicus curiae* in the Oesterreich case and was permitted to use the full time assigned to the respondent for oral argument in the latter case.

This court in the Oesterreich case upon full consideration filed an opinion the effect of which was to determine the cause in favor of Walburga Oesterreich in No. 13,924 and against Wilshire Holding Company in the above entitled cause which was inseparably connected therewith.

Thereafter, this court denied a petition of Wilshire Holding Company for leave to file a petition for rehearing in the Oesterreich case.

The Clerk of this Court has received a representation which is in the official records here and which this court

elects to treat as a motion) by counsel for Walburga Oesterreich suggesting that the Commissioner of Internal Revenue among other things refuses to process the tax for years subsequent to 1946 and therefore requests the court to entertain a petition requiring the Commissioner to show cause why he should not proceed with such processing.

The court finding no reason why determination should now be delayed summarily reverses the determination in the above entitled cause No. 14,100 based upon the previous determination and opinion in the companion case of Walburga Oesterreich vs. Commissioner of Internal Revenue No. 13,924.

James Alger Fee,
Richard H. Chambers,
*Circuit Judges.*

Dave W. Ling,
*District Judge.*